

NORTHWESTERN CORPORATION (NYSE: NWE)

Ugggggggh, More MPSC Shenanigans: Reducing Rating, Target Price

Ticker: NWE
Rating: Sell
Target Price: \$52.00

Market Data

Price: \$58.54
Market Cap (\$MM): \$2,838
Indicated Dividend: \$2.100
Ind. Dividend Yield: 3.59%
Div. Payout: 61.6%
Debt/Total Capital: 54.2%[#]
Book Value: \$35.26
Price-to-Book: 1.66x
LT EPS Growth: 1.2%
52 Week High/Low: \$63.86/\$53.85
Avg. Daily Volume: 332,215

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- The Montana Public Service Commission (MPSC) held additional testimony in docket D2017.5.39 on Friday morning to review NorthWestern's supply tracker.
- Based on the meeting, we are very concerned that the MPSC intends a material reduction in NorthWestern's revenues relatively soon.
- We cannot be certain how or when but we would bet the MPSC is trying hard to beat NorthWestern to a GRC filing.
- In our view, investors need to be very cautious of what is going on in Montana.
- We are reducing our investment rating on NorthWestern Corporation (NYSE: NWE) to Sell from Hold on July 31, 2017 at a price of \$58.54. We are also reducing our target price to \$52.00 from \$64.00.
- We are worried that not only will an adverse regulatory environment and outcomes affect the stock, but that NWE valuation could begin to look like some of the other low growth utilities trading at closer to 15.0x-16.0x P/E multiples with dividend yields of 4.0% or higher.
- Our target price reflects a material discount due to the current regulatory uncertainties of Montana.
- Please see our revised earnings estimates for 2017-2019 below and our 20 Questions for Management on page 14.

EPS Outlook		Q1	Q2	Q3	Q4	Year
2011	Actual	\$0.89A	\$0.30A	\$0.45A	\$0.83A	\$2.47A
2012	Actual	\$0.88A	\$0.31A	\$0.46A	\$0.72A	\$2.36A
2013	Actual	\$1.01A	\$0.38A	\$0.45A	\$0.73A	\$2.56A
2014	Actual	\$1.21A	\$0.24A	\$0.37A	\$0.92A	\$2.76A
2015	Actual	\$1.09A	\$0.46A	\$0.50A	\$0.93A	\$2.98A
2016	Actual	\$0.92A	\$0.58A	\$0.66A	\$0.95A	\$3.10A
2017	Current	\$1.17A	\$0.45A	\$0.75E	\$1.04E	\$3.41E
	Prior					
2018	Current	\$1.16E	\$0.48E	\$0.74E	\$1.05E	\$3.44E
	Prior	\$1.18E	\$0.49E	\$0.76E	\$1.07E	\$3.50E
2019	Current					\$3.26E
	Prior					\$3.60E

Notes: 2013 recurring EPS excludes Q3 -\$2.8 mil p-t, -\$1.7 mil a-t, -\$0.04 PPL hydro acq. transaction costs, incl. \$1.2 mil prior period DSM, -\$3.5 mil p-t, -\$2.2 mil a-t, -\$0.04 PPL hydro acq. transaction costs, incl. -\$0.6 mil prior period DSM. 2014 excludes -\$9.5 mil a-t, -\$0.24 Hydro transaction costs, \$18.5 mil, \$0.47 tax benefit. 2015 excludes Q2 \$20.8 mil p-t, \$12.8 mil a-t, \$0.27 insurance recovery benefit, -\$3.75 mil a-t, -\$0.08 QF adjustment. 2016 Excludes Q1 -\$10.3 mil p-t, -\$6.2 mil a-t, -\$0.13 MPSC Colstrip/generation planning cost disallowances, Q2 \$14.2 mil p-t, \$8.7 mil a-t, \$0.18 LRAM deferred rev. recognition for prior periods, -\$1.3 mil a-t, -\$0.03 Colstrip disallowance chg., Q3 \$12.5 mil a-t, \$0.26 repairs tax deduction tax acctg. chg. for prior periods. [#] Excluding capital leases

	2011A	2012A	2013A	2014A	2015A	2016A	2017E	2018E	2019E
P/E	14.5x	14.7x	17.7x	20.5x	18.2x	18.3x	17.2x	17.0x	18.0x
Div. Payout	58.4%	62.8%	59.4%	57.9%	64.3%	64.4%	61.6%	64.0%	

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This docket warrants close attention for NWE investors.

Another Disturbing MPSC Meeting

Yes, we are tired of writing about it too! The Montana Public Service Commission (MPSC) held additional testimony in docket D2017.5.39 on Friday morning. The docket is the MPSC's review of NorthWestern's supply tracker to recover the company's electricity supply costs. The MPSC is evaluating alternatives to the current supply tracker as HB193 gives the authority to the MPSC to modify or abolish the tracker. As part of the docket, the MPSC is deciding whether to require NorthWestern to submit significant generation information by September 30 that is akin to the scope of a normal general rate case filing. The MPSC has said that the data request is necessary to establish a revised or eliminated supply tracker alternative. NorthWestern has resisted this and alternatively proposed a full GRC filing for May 2018 (accelerated relative to its earlier September plans) and a revision to the current tracker to be replaced with something like Oregon's PCAM.

Unfortunately, the discussion on Friday was frightening. We went into the meeting with the concern that the MPSC might order a GRC filing sooner than the company's May 2018 proposal. **It is now clearer to us that the MPSC's intentions are much broader and more sinister, in our view.** The MPSC's data request appears to be intended to provide the evidence to reduce the company's fixed generation costs. The data request certainly seems excessive for a supply tracker and more appropriate for a generation rate case, which has neither been filed or ordered. Since NorthWestern's return on generation well exceeds that on the T&D portion of rate base, we believe that the MPSC has little interest in a GRC at this time and is likely to deny NorthWestern's alternative proposal. We expect the commission to compel the data request next Tuesday.

In our opinion, the MPSC is angling to reduce fixed generation costs outside of a full base rate case, either in the supply tracker docket, or using the docket as discovery for a separate docket. On Friday, the Montana Consumer Counsel's (MCC) attorney even warned against partial rate cases, single issue ratemaking, retroactive ratemaking, and the MPSC's apparent "advocacy" while saying the MCC would prefer to see a full GRC. He also noted that the MPSC has not demonstrated a long history or significant magnitude of over-earning at NorthWestern.

Several of the commissioners explicitly hinted at their disdain for the carbon element in NorthWestern's hydroelectric rate base (about \$270 million). One commissioner specifically queried NorthWestern's counsel "how concerned would you be if the commission seriously considered removing from rate base...the carbon portion of the pre-approved hydro purchase...?" We cannot be sure if this is the actual specific intent of the MPSC, but rate reduction of some significance certainly appear to be the MPSC's agenda. Unfortunately, the MPSC's only partially hidden agenda is more consumer advocacy or self-serving politics than a neutral quasi-judicial branch is supposed to represent. But, we already knew that the regulatory compact in Montana got thrown out with the bison burger wrapper.

We now wonder if the MPSC actually intentionally set a low avoided cost and eliminated the carbon adder in the QF-1 docket at least partially to make NorthWestern's generation rates look bad and provide an excuse to eliminate the carbon portion of the hydroelectric generation rate base. As the QF counsel suggested in her testimony Friday, the MPSC must now act to eliminate the discriminatory rates allowed to the QFs by either reversing the decision in QF-1 docket or reducing NorthWestern's generation rates, including carbon elements.

The MPSC acting to reduce the hydro rate base would not only reduce NorthWestern's rates/revenues over the short-run, but make a GRC filing less likely to produce an under-earning condition, particularly after the MPSC likely radically reduces the allowed ROE. Therefore, NorthWestern could actually be in line for a two-

step rate cut. This is unbelievable considering NorthWestern has already demonstrated that it is not over-earning in aggregate in its April annual report filing.

While both NorthWestern's and the MCC's presentation testimony appeared to caution against some unusual procedures and content of this fairly narrow docket, the commissioners do not appear to care. Forget whether the MPSC has the legal authority to do this or the procedures and scope of the docket are appropriate. The company could eventually win a judicial review of the outcomes of this docket and/or the new 10-year generation standard set in the QF-1 docket in a few years. We are merely concerned with what the stock will do over the next 12 months if the MPSC continues down this path. Regardless of how they execute on their agenda, the MPSC appears hell bent on reducing NorthWestern's generation rates/revenues in a material way.

We are very concerned that the MPSC intends a material reduction in Northwestern's revenues relatively soon. We cannot be certain how or when, but we would bet the MPSC is trying hard to beat NorthWestern to a GRC filing. In our view, investors need to very cautious of what is going on in Montana.

The implications of a significant rate reduction are obvious for EPS estimates. However, reducing the company's earnings and cash flow could also put significant pressure on the stock and could both increase the dilutive impact of the company's warned equity requirements and the magnitude of the equity needed could grow with any rate reductions. It would have implications for dividend growth and the dividend payout as well. Credit rating downgrades, already almost a certainty, could be more severe. Oh yeah, and the MPSC is likely to significantly increase regulatory lag and reduce cash flow benefits inherent in the tracker mechanism itself, probably eliminating it and many of the component costs currently recovered via the tracker. However, now that seems like small potatoes compared to the bigger issues in play.

The docket continues at 11:30 ET on Tuesday, August 1. The video feed is available at www.psc.mt.gov/video.asp.

Earnings Estimates/Growth Outlook

We are reducing estimates today to reflect a change in our expectations for electric rates in Montana over the next couple of years. We are reversing the rate increase for 2019 we previously expected and are implementing an assumed rate reduction. The company has committed to filing a 2018 GRC and any pain the company will receive will certainly occur by 2019. As we noted previously, we worry that the MPSC is planning to cut NorthWestern's revenues materially prior to that. Therefore, there is a risk that our 2018 estimate is materially optimistic. We simply cannot predict the outcome, magnitude, or timing of the ultimate risk yet.

However, we can identify some of the potential risks. We have added additional equity to our assumption

Exhibit 1: Recurring 2017 Segment Estimates

	Q1/17A	Q2/17A	Q3/17E	Q4/17E		FY17E	Yr/Yr	% of Total
Operating:	\$1.17	\$0.45	\$0.75	\$1.04	\$3.41	\$3.41	9.7%	
Reported:	\$1.17	\$0.45				\$1.61	-52.4%	
Electric Utility	\$0.70	\$0.49	\$0.88	\$0.70	\$134.55	\$2.78	5.8%	81.5%
Gas Utility	\$0.42	\$0.00	-\$0.12	\$0.32	\$29.98	\$0.62	34.7%	18.2%
Corp. & Other	\$0.05	-\$0.04	-\$0.01	\$0.02	\$0.58	\$0.01	-46.9%	0.3%
Total Diversified	\$0.05	-\$0.04	-\$0.01	\$0.02		\$0.01	-46.9%	
Total	\$1.17	\$0.45	\$0.75	\$1.04		\$3.41	9.7%	
Avg. Diluted Shares	48.503	48.581	48.603	48.653		48.585		
Recurring Earnings	\$56.567	\$21.830	\$36.500	\$50.750		\$165.647		

Source: Williams Capital estimates, NorthWestern

While 2017 should be a good earnings year due to better weather, the longer-term outlook is highly uncertain.

for 2018 and reduced the price we assume the equity is issued at, increasing the dilutive effect for the year. We estimate that extra dilution amounts to about \$0.06-\$0.08 per share. **Should the MPSC reduce the hydro rate base by \$270 million as discussed on Friday, the earnings impact would be about -\$0.26 per share in 2018.** There is no guarantee that this is the figure for a rate reduction the MPSC is looking for, but that appears to be a good starting point for the risk discussion. While we do not reflect that in our 2018 estimates yet, we are concerned about the potential.

Our 2017 recurring EPS estimate of \$3.41 and quarterly estimates as shown on page 1 and page 3 are unchanged. We generally expect operating cost controls initiated by management and warm Q317 temperatures to temper the Q217 shortfall. Our estimates largely reflect the Montana natural gas rate case settlement, a return to normal weather (with a better than normal Q117, below normal Q217, warmer than normal Q317, and near neutral Q417 temperatures compared with Q416), and revised O&M, property tax, and D&A expense assumptions. While 2016 had numerous visible earnings drivers, in the absence of new capital projects, acquisitions, or details of rate case filings, 2017 should be fairly simple, in our view. Essentially, we expect some operating cost pressures and de minimus equity dilution to be partially offset by better weather, load growth, improved gross margin, and the Montana natural gas rate increase.

Our 2017 estimates generally reflect:

- A return to more normal weather, a +\$0.14 per share net benefit;
- An improvement in gross margin of \$0.20, excluding weather;
- 1.0% retail energy load growth (+\$0.09);
- and the Montana natural gas base rate increase (+\$0.03, approximately 40% of the year).

We expect these positive catalysts to be partially offset by:

- O&M expense inflation of -\$0.05 per share;
- DD&A expense inflation of -\$0.12;
- property tax inflation (less tracker covered portion) of -\$0.08;
- an increase in interest expense of -\$0.00 which is moderated by the refinancing of a 6.0% issue that should largely offset higher debt balances;
- and -\$0.00 equity dilution.

A higher effective tax rate of 9.0% is reflected in our estimates. Again, the outcome of natural gas resource acquisitions, new capital projects, and a potential material equity issuance could also influence 2017 results and beyond significantly. Our 2017 estimates reflect 48.6 million average diluted shares. While 2017 EPS should increase about 10% compared with 2016 due to a return to more normal weather, it is an unusual annual increase.

Positive 2018 and 2019 EPS catalysts are harder to identify at this point.

We are also reducing our 2018 recurring EPS estimate to \$3.44 from \$3.50 with quarterly estimates as shown on page 1. Our estimate represents roughly 0.9% annual EPS growth. The principal change to our outlook is the potential for equity dilution as discussed on the Q217 earnings call. We increased our equity assumption to \$100 million and reduced NWE share prices effective in that issuance. We do expect credit rating downgrades. While we cannot account for how the tracker changes may affect NorthWestern's cash flow yet or if a reduction in generation rates will be executed by then, we are assuming \$100 million of equity will be issued in late 2017/early 2018. The later the better to meet management's 2017 guidance range. We estimate that \$50 million is enough equity to provide about another 60 basis points of cushion to the FFO/debt ratio. As we expect the MPSC's intentions to be better known by the end of the year, we expect the equity need to be more obvious at that time. Of course, credit rating concerns should be evident by then.

Our estimates generally reflect a full-year Montana natural gas base rate increase (+\$0.04), 1% retail energy load growth (+\$0.09), an increase in gross margin (+\$0.19), less net operating expense inflation of -\$0.20 per share (largely O&M, DD&A, property taxes). Debt refinancing at lower cost and AFUDC for construction projects should also more than offset higher debt balances. A refinancing of \$250 million, 6.34% debt should be particularly beneficial for the year. Our estimates reflect 50.6 million average diluted shares (-\$0.13). A higher effective tax rate of 10.0% is also reflected in our estimates. There is significant risk to our 2018 estimate depending on the timing of any MPSC action to reduce rates.

We are also reducing our 2019 recurring EPS estimate to \$3.26 from \$3.60. Our 2019 estimate largely reflects our assumptions for load growth, an \$11 million Montana electric rate reduction, and the likely 2018 equity dilution. More equity dilution than our \$100 million assumption, a larger Montana electric rate reduction, and materially reduced power cost and/or property tax recovery mechanism recoveries creating more regulatory lag are risks to our outlook, in our view. Our estimates reflect 50.8 million average diluted shares (-\$0.02). We could see worst case scenarios reducing 2018-2019 EPS to the \$3.00-\$3.15 level.

Based on our revised estimates, we expect long-term (5-year CAGR) EPS growth of only 1.2% (reduced from 3.8%) absent any generation investment opportunities or better regulatory outcomes. However, we note that the 5-year growth rate benefits from a very low 2016 base year that was significantly reduced by El Niño weather conditions. Our weather-normalized growth rate is closer to 0.0%. Of course, **this suggests that the total return profile for NWE could be well below the low-end of the 7%-10% management target range.**

Recent material adverse rulings and opinions from the Montana Public Service Commission (MPSC) over the past several years are a concern for us. The MPSC previously eliminated the company's Lost Revenue Adjustment Mechanism (LRAM) in September 2015. The decision reduced NorthWestern's annual revenues by about \$7 million. The reduction of authorized natural gas production rates and the recent Colstrip disallowances have also materially affected company financial results in recent periods. Of late, the MPSC has objected to NorthWestern's new generation proposals despite a reserve margin deficit of nearly 30% and actively worked with the legislature to adversely modify a property tax expense tracking mechanism. The MPSC has taken to making unusual proclamations of how evil utilities (not just NorthWestern) are in public press releases. It remains rogue regulatory mayhem up there! We are not sure what has the MPSC in a punitive mood in relation to the company, but it certainly does not bode well for the company's regulatory relations, in our view. It certainly does not bode well for the company's Montana base electric rate case in 2018 or the ability of the company to receive approval for future generation resource filings with this unpredictable commission, in our opinion. The dubious Montana regulatory climate is a considerable negative for NorthWestern's growth potential, ability to reduce the company's (and customers') exposure to the wholesale power market, and is a material detriment to the company's cost of capital, in our view. What was once an up and coming regulatory environment appears deeply flawed at this point, in our view.

On a potentially positive note (although not currently looking good at all), NorthWestern filed its biennial Montana electricity supply resource procurement plan with the Montana Public Service Commission (MPSC) on April 1, 2016. NorthWestern's filing suggests significant capacity shortfalls developing (including the Boardman and Centralia retirements) in the region and notes the company's current -28% planning reserve margin, -338 megawatt (MW) shortfall. With load growth, the company expects the company's Montana capacity shortage to grow to 688 MWs in later years. While the company does not address it in this filing, it will also ultimately need to establish a reserve margin of about 15% at some point. Effectively, the company's filing outlines its plan to meet its minimum load over the next 10 years, establishing a neutral reserve margin by 2028. To meet this goal, the company developed a specific optimal set of

Recent MT regulatory decisions have been near universally bad.

*New investments in 689 MW, \$1.3+ billion through 2028 are possible...
...but delayed indefinitely.*

generation projects to add 689 MW of new generation capacity. The initial cost estimate for the 689 MWs is about \$1.3 billion. The company also notes 86 MW of additional hydro capacity projects as opportunities to add additional capacity without estimating timing or costs. The figures exclude the capacity and costs associated with another 86 MW of hydro expansion opportunities. The company also notes that it retains significant flexibility to adjust to actual load growth and regional developments in its plan given the phased stages of plant additions envisioned through 2029. NorthWestern's capacity plan is a significant enhancement to the company's future growth outlook, in our view. We expect the company to provide further details of its plan and CAPEX as the year progresses. Unfortunately, the vast majority of the generation capital spend is back-end loaded for after 2020, providing little support for our near-term outlook. Also, given the current mood of the MPSC, it is difficult to gauge the ultimate outcome of the company's plan to improve its generation capacity and reserve margins. While regulatory opposition to what appears to be a logical plan has derailed any near-term opportunity for the company, the outcome is inevitable in the long-run.

Our enthusiasm for the company's growth prospects has largely been derailed by the MPSC. While planned company CAPEX still will exceed D&A by almost 100% over the next five years, the considerable growth potential for the company related to generation needs are not a near-term issue. Rate base growth could be high depending on the details of new generation plans/timing. The 2020-2030 period could be a very exciting time for the company's growth due to significant generation investments needed. We note that the extension of bonus D&A and wind tax benefits in 2015 and current MPSC "dynamics" could significantly affect the company's eventual capital plans. Fortunately, in the absence of major acquisitions or more robust generation investment plans, we also do not expect material equity dilution to affect EPS growth through 2021. In the meantime, low growth appears more likely for the company. NorthWestern said as much on the Q416 earnings call. Our 5-year EPS growth rate estimate for NorthWestern of 3.8% looks somewhat sluggish compared with peers, in our view. Regulatory treatment of power cost recovery and property trackers could affect our growth outlook still as well.

Considerable uncertainties remain for the company related to potential new Montana generation, natural gas production acquisitions/depletion, distribution and transmission reliability plans (DSIP & TSIP), and environmental compliance capital requirements, in our view. The sometimes Machiavellian machinations of the MPSC only exacerbate the uncertainties related to NorthWestern's potential capital expenditures, regulatory relief requirements, and the timing of the company's full earnings potential, in our opinion. Therefore, greater clarity of the company's capital expenditure and rate case plans could still affect our earnings and equity assumptions materially over the next few years. Our estimates only reflect our understanding of currently anticipated and defined capital projects and rate filings. We are not ready to forecast the timing or magnitude of the Montana electric GRC we expect to be filed at some point. However, we do expect the MPSC to eventually approve new generation projects as they appear to advance state policy objectives. Given the considerably lower earned ROE, natural gas rate proceedings in Montana could be less difficult. However, the process may not always appear friendly as recent adverse MPSC orders have highlighted and could result in a more worrisome electric rate case, in our view.

Other Recent Events

Q217 Conference Call - On the July 26 call, management reiterated its 2017 EPS guidance of \$3.30-\$3.50. Management noted some unusually high operating costs, particularly property tax expense, in 1H17 that it expects to be less challenging in 2H17. The weather has been very hot in July and the company has implemented cost controls again to help meet 2017 guidance. Management appears bent on meeting the guidance range, in our view. Debt-to-capitalization declined below the 55.0% level for the first quarter in awhile to reach 54.8%. The company's latest guidance reflects 48.6 million average diluted shares, normal weather and a range of anticipated effective income tax rates of 7%-11% (recurring). The company

maintained its CAPEX guidance through 2021 but noted that about \$100 million of the CAPEX budget still includes new Montana generation.

NorthWestern CFO Brian Bird maintained the company's expectations for attaining the lower-end of its 7%-10% annual total return target due to the lower capital expenditures and recent adverse regulatory decisions and the delays regarding new generation investment proposals but noted that cost controls should allow the company to remain within the range. This implies intermediate-term EPS growth for NorthWestern of only about 3.5%, in our view. Management previously noted that it increased the 2017 dividend growth to 5.0% partially to compensate for the lower prospective EPS growth. Management noted that MPSC planned changes to power cost recovery and property tax trackers could make earnings growth even more challenging going forward.

***New equity
dilution?***

Management indicated its plan for a Montana electric rate case filing will be postponed until May 2018 back in April. The company is hoping that proposal holds up as the MPSC will meet Friday morning to discuss power cost recovery mechanism options that could result in an adverse ruling on the rate case timing. While management remains optimistic on the regulatory front, we did not hear any solutions or anything to give us optimism at all. Finally, management noted that credit rating downgrades due to the agencies' deteriorating perception of the regulatory climate in Montana and a potentially more challenging power cost/property tax recovery outlook could put pressure on the company's FFO/debt ratio and require new equity.

***The MPSC decision
hurts COSG
potential in MT and
elsewhere.***

MPSC Settlement Reduction - On July 20, the Montana Public Service Commission (MPSC) approved a settlement agreement in the company's natural gas rate case in docket D2016.9.68. The MPSC could not resist reducing further an already reduced settlement agreement by \$0.6 million to +\$5.1 million, +2.4% per annum. In doing so, the MPSC put out another of its self-serving press releases. The commission objected to some natural gas production benefits failing to live up to projections in 2010-2013.

In addition to another haircut coming from the MPSC at NorthWestern's expense, the commission's scrutiny of NorthWestern's Cost of Service Gas (COSG) programs certainly will make incremental investments more difficult. More far reaching effects could be felt on the utility industry as a whole as this case will certainly draw the attention of other state regulators, making COSG investments in other states less likely as they point to the precedent of NorthWestern's difficulty in meeting projected COSG benefits in their program.

***The MPSC
introduced new
investment criteria
for NorthWestern
that is simply
onerous.***

MPSC Work Sessions - On June 22 and June 29, the Montana Public Service Commission (MPSC) held several work sessions addressing various NorthWestern related issues. While the MPSC addressed the passage of HB 193 in Montana which allows the commission to adjust NorthWestern's power supply tracker, the tracker issue is now a relatively minor issue, in our view. Forget the fact that trackers are very common in the U.S. and help to reduce financing costs for consumers, the MPSC appears to abhor them nonetheless and any tracker changes are not likely to be beneficial to NorthWestern.

***NorthWestern is
not likely to add
significant new
generation
resources at this
point.***

Of greater consequence was what followed. The MPSC reduced the terms on which Qualifying Facility (QF) generators can participate in the generation market. Most importantly, while the QF tariff rate was substantially reduced, limiting QF opportunities materially, the QF contract (PPA) term was also reduced to a maximum of 10 years with a rate adjustment after five years. Essentially, QFs now only have a five year contract to base financing on. While we are no fan of QFs, they have been an archaic concept that has inundated the western states with unacceptable consumer costs, these terms essentially kill off the QF market entirely, in our opinion. While that may have been the commission's intention, what followed is unprecedented as far as we know.

NorthWestern suffered a new indignity as the MPSC voted to essentially hold the utility to the same QF standards for new generation resources. The commission put out one of its self-aggrandizing and unique to state commission press releases to signify the event. The commission bemoaned the risk of "forecast error" in deciding to limit contract terms. Yes, forecast error does put consumers at some risk of a flawed forecast. Frankly, it is the commission's role to determine the prudence of a power supply/market price forecast in determining if a new generation resource is prudent and in the interests of consumers. Saying "we accept the forecast for five years, then we will re-evaluate your investment" is not the regulatory compact as it exists in America today. A commission cannot adjust rates with perfect information in five years while the utility does not have that same opportunity. Someone has to make that determination before construction of new electric utility (or QF) assets, and that is the commission's job. To later decide with actual information that an asset is imprudent after 100s of millions of dollars of investment has been made runs counter to the regulatory compact at its core. Frankly, utilities have generally done a good job of providing for utility resources on a timely basis. When they have not, they are not allowed to add additional resources until the actual consumer usage warrants a new investment. The necessity of this added condition on utilities in Montana appears unnecessary. The MPSC reiterated its intention to not guarantee fixed cost recovery of new generation resources beyond 10 years in its final order in the QF docket on July 21.

Settlement was close to our expectations.

Natural Gas GRC Settlement - On June 12, NorthWestern announced a settlement agreement in its natural gas rate case. NorthWestern agreed to a \$5.7 million, 2.9% increase in revenues. The settlement agreement is just over 50% of the initial \$10.9 million revenue request. The settlement reflects a 9.55% ROE, 46.8% equity component as filed, and a 6.96% overall rate of return.

Montana ROE Filing - On April 26, the company filed its annual compliance report in Montana indicating an adjusted earned ROE of 9.376% in 2016. In the filing, the company declared its intention to file a Montana electric GRC by September 30, 2018.

Montana Gas Case - On April 7, the company filed its final rebuttal testimony in the Montana natural gas case. The company has reduced its rate request to +\$9.4 million, +5.0% from the previous +\$10.9 million, +8.0% amount. A decision is expected by mid-year.

Moody's Downgrade - On March 10, Moody's reduced the company's credit rating one notch to A2 and maintained the negative outlook on NorthWestern.

Dividend Increase - On February 17, the company raised the common dividend 5.0% to \$0.525, \$2.10 from \$0.50, \$2.00. The increase represented a more aggressive increase compared to the 4.2% increase in 2015. As CFO Brian Bird noted on the Q416 earnings call, the more generous increase was related to lower near-term EPS growth expectations.

Investment Opinion

Reducing our rating to Sell, target price to \$52.00.

We are reducing our investment rating on NorthWestern Corporation (NYSE: NWE) to Sell from Hold on July 31, 2017 at a price of \$58.54. We are also reducing our target price to \$52.00 from \$64.00. Our reduced target price reflects our estimate revisions and a significant reduction in our target valuation. We are worried that not only will an adverse regulatory environment and outcomes affect the stock, but that NWE valuation could begin to look like some of the other low growth utilities trading at closer to 15.0x-16.0x P/E multiples with dividend yields of 4.0% or higher. You know what those stocks are. Our target price reflects a material discount to due to the current regulatory uncertainties of Montana.

The risks related to the potential for material equity dilution, further credit rating downgrades, additional adverse regulatory outcomes, and a potential for a further degradation of NWE's forward fundamental

Exhibit 2: Our Valuation Worksheet

	2003A	2004A	2005A	2006A	2007A	2008A	2009A	2010A	2011A	2012A	2013A	2014A	2015A	2016A	2017E	2018E	2019E
EPS	\$2.69	\$0.37	\$1.30	\$1.54	\$1.44	\$1.72	\$1.68	\$2.07	\$2.47	\$2.36	\$2.56	\$2.76	\$2.98	\$3.10	\$3.41	\$3.44	\$3.26
Book Value	-\$15.55	\$19.92	\$20.71	\$20.84	\$21.12	\$21.25	\$21.86	\$22.64	\$23.68	\$25.09	\$26.60	\$31.50	\$33.22	\$34.68	\$35.86	\$37.64	\$38.39
Dividend	\$0.00	\$0.00	\$1.00	\$1.24	\$1.28	\$1.32	\$1.34	\$1.36	\$1.44	\$1.48	\$1.52	\$1.60	\$1.92	\$2.00	\$2.10	\$2.20	\$2.30
Payout	0.0%	0.0%	77.0%	80.4%	89.2%	76.8%	79.7%	65.8%	58.4%	62.8%	59.4%	57.9%	64.3%	64.4%	61.5%	64.0%	70.5%
Oper. Cash Flow	-\$2.86	\$4.10	\$4.06	\$4.40	\$5.45	\$5.18	\$3.22	\$6.04	\$6.40	\$6.78	\$5.07	\$6.18	\$7.13	\$5.96	\$7.49	\$7.45	\$7.44
Yield @ 4.00%	0.0%	0.0%	3.2%	3.5%	4.3%	5.6%	5.1%	4.7%	4.0%	4.3%	3.5%	2.8%	3.5%	3.5%	\$52.50	\$55.00	\$57.50
Yield @ 4.50%															\$46.67	\$48.89	\$51.11
P/E @ 16.0x	0.0x	76.1x	23.9x	22.9x	20.6x	13.7x	15.5x	13.9x	14.5x	14.7x	16.9x	20.5x	18.2x	18.3x	\$54.60	\$54.97	\$52.20
Price-to-Book @ 1.5x	0.0x	1.4x	1.5x	1.7x	1.4x	1.1x	1.2x	1.3x	1.5x	1.4x	1.6x	1.8x	1.6x	1.6x	\$53.78	\$56.46	\$57.59
Price-to-Cash Flow @ 7.0x	0.0x	6.8x	7.7x	8.0x	5.4x	4.5x	8.1x	4.8x	5.6x	5.1x	8.5x	9.1x	7.6x	9.5x	\$52.45	\$52.18	\$52.05
EV/EBITDA - @ 10.0x	12.4x	9.5x	8.0x	9.7x	8.8x	6.7x	8.0x	8.4x	9.0x	8.1x	10.5x	15.1x	11.3x	12.0x	\$46.62	\$47.89	\$45.37
Average of Absolute Prices	\$0.08	\$28.00	\$31.07	\$35.38	\$29.50	\$23.47	\$26.02	\$28.83	\$35.79	\$34.73	\$43.32	\$56.58	\$54.25	\$56.87	\$51.10	\$52.56	\$52.64

Source: Williams Capital estimates, NorthWestern

outlook given pending MPSC reviews of cost recovery mechanisms provide too much uncertainty at this point, in our opinion. Forget about the risks associated with a prospective Montana electric rate case, those are enough reason to give any investor heartburn.

Our rating and target valuation reflects the significantly reduced growth outlook over the near-term and the unfavorable/contentious regulatory environment in Montana. The modest, below peer average intermediate-term growth outlook and a seemingly deteriorating Montana regulatory climate remain concerns for us.

Our target price reflects a P/E of 16.0x our 2019 EPS estimate, and roughly a -7.6% total return potential over the next 12 months, including the current indicated dividend yield of 3.59%. Our target price reflects a potential capital loss on the stock of -11.2%. Our target valuation reflects a material discount to the average P/E for the stock over the past three years, but more comparable to average P/E relative to the past decade for NWE shares despite some higher comparable valuations, particularly in light of recent regulatory outcomes in Montana.

This year should be another positive EPS growth year (+10.0%) for the company despite unfavorable weather after an impressive decade of nearly 9.0% compounded EPS growth and a string of successful growth transactions. After the strong performance from 2015 results due to the Montana hydro asset acquisition, the acquisition of Beethoven wind farm, and the successful conclusion of the South Dakota electric base rate case, we expect another positive year in 2017 due to the reversal of the effects of very strong El Niño conditions on 2016. Cost control efforts should continue to be essential to future earnings growth.

We find the company enjoying many attractive characteristics at this time:

- **Free Cash Flow** - NorthWestern is one of the rare utilities producing free cash flow that we expect to be in the \$50-\$75 million range annually for the next few years (based on the latest CAPEX budget). We love free cash flow generators.
- **Significant Growth Opportunities** - The company's April 2016 Montana electricity supply resource procurement plan filing outlines a very attractive set of significant growth opportunities that we hope can successfully navigate the MPSC eventually. The plan also implies additional opportunities beyond the stated capacity goals and assumes what appears to be a very conservative load growth outlook.
- **Strong Economy** - Economic growth in the company's service areas is better than the overall U.S., leading to above average utility customer/energy demand growth for both electricity and natural gas

Our otherwise favorable fundamental outlook is reduced by regulatory lag, less tangible near-term growth, and an apparently hostile MPSC.

utilities.

- **Gas Supply Acquisitions** - The company still has opportunities to acquire additional natural gas reserves in Montana and we expect new generation in Montana to fuel demand for natural gas over time.
- **Consistent Rate Base Growth** - Overall, capital expenditures well in excess of DD&A should yield additional significant rate base growth of \$450-\$600 million over the next five years.

As Moody's noted in reducing NorthWestern's credit outlook to negative in 2016, the fundamental outlook for the company is significantly less clear after 2016 with few definitive fundamental drivers. The company is likely to require additional generation resources regularly over the next 20 years or so to address a widening gap between resources and peak demand loads. Yet, the opportunity remains unclear (particularly as it relates to the MPSC's view).

In the absence of new large investment/earnings opportunities over the near-term, in our opinion, the following uncertainties cloud the outlook for NWE shares:

A modest growth outlook and regulatory issues weigh very heavily on the stock's potential, in our view.

- **Valuation** - The dividend yield of 3.59% is attractive relative to peer utility yields of closer to 3.0% in a yield-oriented market. Should regulatory relations improve or the growth outlook accelerate, the stock's discount to peers would prove attractive. However, until then, NorthWestern's low growth profile and regulatory issues is deserving of a far lesser valuation than peers. We are concerned that NWE's valuation could approach that of the slow growth large caps that are yielding over 4.0% despite having expecting growth of over 3.0% that is better than NWE's prospectively, in our view.
- **Near-Term EPS Growth** - We expect only EPS growth of 0%-1% over the next few years. This level of growth is inferior to most of its peers and should weigh on the stock's potential for now.
- **Dividend Growth** - The company's target dividend payout of 60%-70% suggests continued, if moderate dividend growth. We fear that the outcomes the MPSC provides over the next 18 months could put the company in a lower dividend growth mode.
- **Balance Sheet** - The company's balance sheet is a question mark for us depending on MPSC decisions over the near-term. However, the equity issuance we expect should leave the balance sheet relatively stable, in our view.
- **Rate Cases** - The growing gap between authorized and actual rate base in Montana will require a base electric rate case in 2018. The MPSC also expects a GRC filing sooner rather than later. At this point, a filing appears both dangerous and unlikely to yield a favorable outcome, in our view. The complexities of the case, the size, and the timing of the case provide little insight into NorthWestern's earnings subsequent to 2017. More capital investment riders, automatic rate adjustment mechanisms, and conservation/lost revenue recovery, etc. would be useful for the company, and are a beneficial staple in many other jurisdictions. Unfortunately, we do not expect any of these things from the MPSC.
- **Few Near-Term EPS Catalysts** - Until the realization of the Montana natural gas case growth, and a Montana electric base rate case filing, cost control efforts and load growth will dominate the company's outlook and will put pressure on NorthWestern's financial results after 2017, in our view.
- **Regulatory Environment** - The Montana Public Service Commission (MPSC) eliminated the Lost Revenue Adjustment Mechanism (LRAM) in 2015 in what appeared to us to be a punitive decision. Not only did the decision reduce annual revenues by about \$7 million annually, in our opinion, it does not bode well for prospective Montana rate filings with this often capricious and mercurial commission. The Colstrip disallowance and legislative efforts to fight tracking mechanisms only reaffirmed that the MPSC can be an unreliable and shareholder unfriendly regulatory jurisdiction (again), in our view. Things have only gotten worse over time, in our opinion. The recent QF-related vote reducing the opportunities for new generation investment was only icing on what was already a bad cake.
- **Poorly Defined Growth** - While we were certainly excited by the company's Montana electric generation resource needs longer-term, no Montana generation opportunity is yet to be approved,

The MPSC is more than enough reason not to favor the stock.

appears contentious, and remains uncertain in terms of amounts and timing. Certainly, much of the opportunity is outside of both our forecast period and valuation window.

- **Declining Tax Benefits** - As we approach later in the decade, declining tax benefits will eventually begin to put pressure on NorthWestern's effective income tax rate, adding some additional pressure on the company's financial results over time.

In our view, NorthWestern remains in a very good strategic position. The merits of NWE's plain vanilla utility growth strategy appear only clearer in the current defensive market environment, in our opinion. We expect rate base to grow modestly through 2021 due to less aggressive net rate base growth, natural gas production acquisition potential, distribution/transmission reliability capital spending, and with some further customer growth, in our view. The considerable decline in the stock since the 2016 peak also alleviated our concerns about previously excessive valuations, in our view. As we continue to monitor the company, additional insights into the company's fundamental prospects and rate filing schedules/plans could prove material to our opinion over the next 12 months. However, generation resource investment delays are a disappointment. The regulatory environment for the company in Montana also scares us silly. We can see potential here eventually, however; due to the regulatory risks current present in Montana, investors need to avoid the stock for awhile, in our opinion.

Valuation

We see fair value for NWE shares of \$52.00 being readily achievable over the next 12-months as the stock is valued more directly on 2019 earnings, dividend, and cash flow expectations, equity is issued, inevitable credit rating downgrades are completed, the base rate issues/outcomes/filings become clearer, regulatory risk is reduced, and new rates are implemented, in our view. We note that our target valuation is a composite of multiple techniques that does not rely solely on P/E to determine our target price.

We derive our 12-month valuation for the stock using multiple valuation methodologies, including a sum-of-the parts, price-to-earnings, price-to-book, dividend yield, price-to-cash flow, and Enterprise Value-to-EBITDA methodologies based on our 2019 fundamental estimates. We have valued NWE shares based largely on NWE's average historic valuation metrics upon which the stock has traded over the past decade with further consideration of utility valuations since dividend tax cuts were enacted in May 2003, the divestiture of the majority of the more volatile non-regulated businesses and re-focus on pure utility operations, the prospective rate base and EPS growth, and the current defensive/yield oriented market.

In NWE's case, we have valued the stock using a Dividend Yield range of 4.00%-4.50%, a Price-to-Book value of 1.4x-1.6x, a Price-to-Cash Flow value of 6.5x-7.5x, an EV/EBITDA value of 9.5x-10.5x and a P/E multiple of 15.5x-16.5x. Utilizing each of the aforementioned valuation methods, we derive a range of values of \$48.00-\$56.00 for the stock based on our 2019 fundamental estimates. Our target price is then effectively the average of theoretical stock price values derived from each of these valuation techniques. We note that our target price reflects a valuation comparable to the stock's 10-year historic valuation metrics.

The stock is currently trading at 18.0x our revised 2019 recurring EPS estimate, at a 3.59% indicated dividend yield, and roughly 1.5x our estimated 2019 year-end book value (1.9x tangible book). In our opinion, the stock is currently trading at a material discount to peer electric utility group valuations that reflects an average P/E of nearly 19.0x-19.5x 2019 EPS and an average dividend yield of roughly 3.0%.

With the stock trading at only 18.0x our 2019 EPS expectations, the stock initially appears attractive relative to most utility peers. However, the company's apparent growth profile pales by comparison to most peers. Our target valuation reflects a P/E valuation of 16.0x our 2019 recurring EPS estimates and a total return potential of about -7.6% over the next 12 months, including the current indicated dividend yield of 3.59%.

Our target price also reflects a potential capital loss on the stock of -11.2%. We note that the stock has generally traded for an average P/E of 16.7x, a median dividend yield of 4.1%, and a median price-to-book of about 1.5x, with a dividend payout of over 64% over the past decade. Over the past three years the valuations have been higher with a P/E averaging 18.3x, an average dividend yield of 3.5%, and an average price-to-book of 1.6x. However, both the company's growth and regulatory environment outlooks have deteriorated relative to the past three years, in our opinion.

In our view, NWE shares deserve a material discount to the combination utility group and its peers for a number of reasons. First, we are making educated assumptions about regulatory outcomes that are inherently risky and critical to NorthWestern's growth and financial outlook. Second, the regulation of the MPSC is at best unfriendly to shareholders and adds to "forecast risk." Finally, the growth is less attractive for NorthWestern for the next few years with limited insight into improvement in the regulatory climate in Montana, NorthWestern's most critical jurisdiction. While the market remains defensive and focused on yield, we do not believe that a higher valuation is appropriate for NWE shares than we reflect in our target price.

Balance Sheet and Liquidity

We are comfortable with current leverage.

NorthWestern's balance sheet stands capitalized at about 44.9% equity, materially more highly levered than is typical for U.S. utilities today. Given rate cases over the near term that should raise annual earnings, and the company's likely free cash flow production in most years based on current capital investment plans, we are comfortable with the company's current temporary leverage. We expect a stable to modestly improving balance sheet due to equity issuance over the next 12 months that will support both the balance sheet and credit ratings. The company maintains approximately \$113 million of consolidated ready cash/liquidity, including roughly \$17 million of cash, through current credit facilities as of Q217 end, and has more than adequate access to the commercial paper and capital markets to fund prospective capital requirements, in our view. The company's senior secured debt is rated A- at Standard & Poor's, A2 at Moody's, and A at Fitch. While S&P and Fitch have NorthWestern on Stable outlooks, Moody's has had the company on negative watch since March 10.

Dividends

The dividend is secure and represents a premium yield relative to most peers.

We believe that NorthWestern's dividend is secure as we expect the 2017-2019 dividend payout to remain in the 60%-65% range for the next few years in the absence of an adverse MPSC ruling. We expect the significant improvement in 2017-2018 earnings and the stable utility source of those earnings to result in a moderate increase in the dividend (4%-5% annually) under current rates. However, a material adverse MPSC ruling that reduces NorthWestern's earnings and cash flow could reduce the company's dividend growth potential. Nevertheless, the current dividend appears secure, particularly given NorthWestern's free cash flow generation and modest debt maturities through 2020, in our view. The stock is providing a current indicated dividend yield of 3.59% which we believe is attractive relative to the electric and natural gas utility groups.

NorthWestern has paid common dividends continuously since 2005. The company has increased the dividend every year since 2004. On February 17 the company raised the dividend 5.0% to \$0.525, \$2.10 per share from \$0.50, \$2.00 per share. In our view, management is dedicated to providing an attractive, competitive yield and a growing dividend. Some of the company's debt covenants can restrict the payment of dividends under conditions that we do not expect.

The 3.59% current indicated dividend yield remains relatively attractive compared with fixed income alternatives and very attractive relative to comparable peer electric utility yields with an average yield of only about 3.0%. We note that the average yield on the stock over the last 10 years has been closer to 4.1%,

but reflective of higher comparable interest rates and dividend yields, higher historical dividend payouts, a greater regulatory risk premium, and more variable earnings power and financial strength, in our view.

Regulatory Environment

An uncertain Montana regulatory climate remains a potential problem with future critical rate cases and resource needs to come.

NorthWestern Corporation, d/b/a NorthWestern Energy is regulated by the Montana Public Service Commission (MPSC), the Nebraska Public Service Commission (NPSC), and the South Dakota Public Utilities Commission (SDPUC). All three are elected commissions for six year terms. Both the Montana and Nebraska commissions consist of five members while the South Dakota commission consists of three. Over 80% of the company's gross margin is derived from the Montana jurisdiction. The Montana commission has a nine month statutory review period and can allow interim rates, but rarely uses them. The South Dakota commission has a six month statutory review period and allows interim rates six months after filing. The Nebraska commission has a seven month statutory review period and allows interim rates 60 days after filing. The Montana legislature meets in alternate (odd) years. The company files an Electricity Supply Resource Procurement Plan (IRP) every two years (odd) that covers a 20 year forecast period.

Much like many elected commissions, the Montana Public Service Commission (MPSC) can certainly be as capricious and unfriendly to shareholders as the best of them, if not the worst in the U.S. The MPSC has a proven track record over the years. The mood of the MPSC changes as often as the commission elections that bring new commissioners to the bench. Just when we thought the MPSC had improved markedly in recent years, we are not sure where the MPSC sits today. The MPSC has now risen beyond the level of the New Mexico Public Regulation Commission (NMPRC), in our opinion.

Given the recent adverse rulings of the MPSC, we are very cautious about the regulatory environment in NorthWestern's most critical state. We might normally wonder what management has done wrong to incite the commission. However, with Bob Rowe at the helm of the company, and given his experience as a commissioner in Montana, the situation suggests otherwise. As a result of the current state of regulatory relations in Montana, we are more cautious about both growth at the company and the valuations we are currently willing to ascribe to the stock.

Company Background

NorthWestern Corporation, based in Sioux Falls, South Dakota is principally a combination electricity and natural gas utility that has a foundation dating back to 1913 in Montana. After failed non-regulated diversification efforts in the 1990s, the company filed for bankruptcy protection in 2003. Emerging from bankruptcy in 2004, the company has been virtually 100% utility focused since. The company has roughly 430,000 electric customers and 300,000 natural gas customers in Montana, South Dakota, and Nebraska. The company also serves Yellowstone National Park in Wyoming. While based in South Dakota, nearly 80% of the company's customers and nearly 80% of the company's gross margin comes from the Montana jurisdiction. Also, nearly 80% of the utility gross margin is derived from the electric utility. The company owns approximately 1,250 megawatts of electric generation.

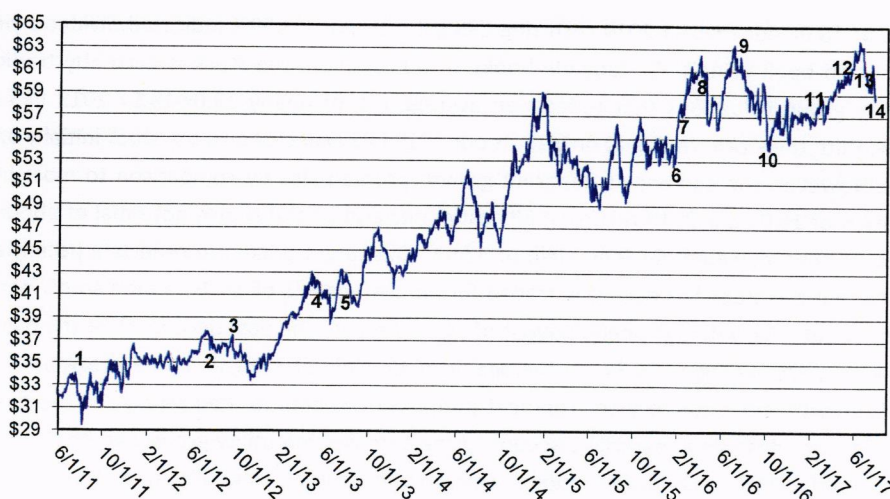
20 Questions for Management

*A useful list of
ready-made
questions for your
upcoming NWE
meetings.*

- 1) How do you interpret the MPSC's current regulatory climate given the recent adverse regulatory decisions (LRAM, gas production, Colstrip disallowances, QF generation investment standard, the MPSC desire for a lower ROE apparently, tracker hatred, etc.)?
- 2) How do you react to the MPSC's new generation investment cost recovery policy?
- 3) How do you expect to address revisions to your Montana generation resource plan?
- 4) How do you expect to address the credit rating downgrade/FFO-to-debt/equity dilution problem? How much, when?
- 5) Do the recent MPSC rulings and the current mood of the MPSC influence your investment thinking?
- 6) What can NorthWestern do to improve the Montana regulatory climate?
- 7) When do you expect to have greater insight into hydro expansion potential?
- 8) When do you expect to have more clarity on regional/state responses to the EPA's plan and your capital plans?
- 9) How do you see Western EIM membership and NERC reserve margin requirements affecting your resource plan/company?
- 10) What are your thoughts on natural gas acquisitions in the current environment?
- 11) Other than your intentions for a Montana rate case filing, what else should we look for in your April Montana annual report filing?
- 12) What are your general thoughts on earned ROEs going forward?
- 13) How does the MPSC's gas case settlement adjustment revise your natural gas acquisition strategy?
- 14) What is the latest on DGGs optimization?
- 15) Can we infer from your growth expectations that operating cost control efforts are a key element of your earnings growth plan for the near term?
- 16) When will you have more details on the MPSC tracker changes?
- 17) Can you elaborate on your South Dakota generation resource plan expectations?
- 18) Do you expect 5% to be a more constant dividend growth rate at this point or will annual increases vacillate over time?
- 19) What are your thoughts on the apparent scope of the supply tracker docket?
- 20) How do you interpret the hydro rate base reduction conversation from the supply docket meeting on July 28?

IMPORTANT INVESTOR DISCLOSURES

STOCK CHART, RATINGS AND PRICE TARGET HISTORY: NORTHWESTERN CORPORATION (NYSE: NWE) AS OF JULY 28, 2017



Source: Yahoo Finance

	Date	Action	Rating	Price	Target Price
14	31-July-17	Reduce Rating/Target Price	Sell	\$58.54	\$52.00
13	5-July-17	Raise Target Price	Hold	\$61.05	\$64.00
12	28-Apr-17	Raise Target Price	Hold	\$60.42	\$61.00
11	21-Feb-17	Reduce Rating	Hold	\$57.62	\$58.00
10	10-Oct-16	Raise Rating	Buy	\$54.09	\$58.00
9	25-July-16	Raise Target Price	Hold	\$62.30	\$58.00
8	6-Apr-16	Raise Target Price	Hold	\$60.89	\$56.00
7	12-Feb-16	Raise Target Price	Hold	\$57.19	\$55.00
6	25-Jan-16	Raise Target Price	Hold	\$53.56	\$54.00
5	26-July-13	Raise Target Price	Hold	\$41.99	\$43.00
4	26-Apr-13	Raise Target Price	Hold	\$41.90#	\$41.00
3	27-Sept-12	Reduce Target Price	Hold	\$36.50	\$36.00
2	26-July-12	Raise Target Price	Hold	\$36.14	\$37.00
1	14-July-11	Initiation of Coverage	Hold	\$33.91	\$35.00

intra-day price

VALUATION METHODOLOGY

We see fair value for NWE shares of \$52.00 being readily achievable over the next 12-months as the stock is valued more directly on 2019 earnings, dividend, and cash flow expectations, equity is issued, inevitable credit rating downgrades are completed, the base rate issues/outcomes/filings become clearer, regulatory risk is reduced, and new rates are implemented, in our view. We note that our target valuation is a composite of multiple techniques that does not rely solely on P/E to determine our target price.

We derive our 12-month valuation for the stock using multiple valuation methodologies, including a sum-of-the parts, price-to-earnings, price-to-book, dividend yield, price-to-cash flow, and Enterprise Value-to-EBITDA methodologies based on our 2019 fundamental estimates. We have valued NWE shares based largely on NWE's average historic valuation metrics upon which the stock has traded over the past decade with further consideration of utility valuations since dividend tax cuts were enacted in May 2003, the divestiture of the majority of the more volatile non-regulated businesses and re-focus on pure utility operations, the prospective rate base and EPS growth, and the current defensive/yield oriented market.

In NWE's case, we have valued the stock using a Dividend Yield range of 4.00%-4.50%, a Price-to-Book value of 1.4x-1.6x, a Price-to-Cash Flow value of 6.5x-7.5x, an EV/EBITDA value of 9.5x-10.5x and a P/E multiple of 15.5x-16.5x. Utilizing each of the aforementioned valuation methods, we derive a range of values of \$48.00-\$56.00 for the stock based on our 2019 fundamental estimates. Our target price is then effectively the average of theoretical stock price values derived from each of these valuation techniques. We note that our target price reflects a valuation comparable to the stock's 10-year historic valuation metrics.

The stock is currently trading at 18.0x our revised 2019 recurring EPS estimate, at a 3.59% indicated dividend yield, and roughly 1.5x our estimated 2019 year-end book value (1.9x tangible book). In our opinion, the stock is currently trading at a material discount to peer electric utility group valuations that reflects an average P/E of nearly 19.0x-19.5x 2019 EPS and an average dividend yield of roughly 3.0%. With the stock trading at only 18.0x our 2019 EPS expectations, the stock initially appears attractive relative to most utility peers. However, the company's apparent growth profile pales by comparison to most peers. Our target valuation reflects a P/E valuation of 16.0x our 2019 recurring EPS estimates and a total return potential of about -7.6% over the next 12 months, including the current indicated dividend yield of 3.59%. Our target price also reflects a potential capital loss on the stock of -11.2%. We note that the stock has generally traded for an average P/E of 16.7x, a median dividend yield of 4.1%, and a median price-to-book of about 1.5x, with a dividend payout of over 64% over the past decade. Over the past three years the valuations have been higher with a P/E averaging 18.3x, an average dividend yield of 3.5%, and an average price-to-book of 1.6x. However, both the company's growth and regulatory environment outlooks have deteriorated relative to the past three years, in our opinion. In our view, NWE shares deserve a material discount to the combination utility group and its peers for a number of reasons. First, we are making educated assumptions about regulatory outcomes that are inherently risky and critical to NorthWestern's growth and financial outlook. Second, the regulation of the MPSC is at best unfriendly to shareholders and adds to "forecast risk." Finally, the growth is less attractive for NorthWestern for the next few years with limited insight into improvement in the regulatory climate in Montana, NorthWestern's most critical jurisdiction. While the market remains defensive and focused on yield, we do not believe that a higher valuation is appropriate for NWE shares than we reflect in our target price.

Risk

In our view, NorthWestern Corporation common shares represent the level of risk that we believe is inherent in an average publicly traded stock/company. Since the Montana PSC authorized Colstrip Unit 4 in regulated rate base, much of the commodity volatility/uncertainty in the company's earnings profile has been reduced. However, the company remains materially short generation (-28% reserve margin). In our view, NorthWestern's risk profile is significantly elevated relative to the average combination electric and natural gas utility due to its small size, the considerable capital growth program the company is undertaking, and the greater regulatory risk associated with the Montana PSC (currently elevated). Nevertheless, the company is entirely composed of traditional regulated utilities, which is an important factor in our risk assessment. We do not foresee any material financial risks at this time. The company is well capitalized and the company's liquidity as represented by its cash flow and fixed charge coverage is very good, in our view. As the company completes its capital programs and potential prospective Montana rate cases, we believe NorthWestern's risk profile should actually become more aligned with a lower risk profile in time, assuming less adverse future decisions from the MPSC.

However, significant delays in filing a Montana electric rate case could begin to affect the company's financial results starting in 2017 as significant capital investments could go without requisite revenue recovery. Difficulty in completing and/or financing the company's growth projects could also materially affect the company's growth profile, earnings and cash flow results, and investor interest in the stock. The regulatory response to the company's investment plans could also affect the timing and ultimate impact of potential investments on earnings and cash flow. The Montana regulatory environment is always a significant risk. However, we believe the company will continue to improve its relationship with Montana regulators and we believe that there is local support for much of the company's infrastructure investment plans in the long term. A significant rise in interest rates or dividend tax rates could also put significant pressure on utility operating costs and utility equity valuations. At this point, we are more worried about macroeconomic issues affecting the stock than company fundamentals other than the Montana regulatory environment. However, the Montana regulatory environment requires constant monitoring given recent adverse decisions and policies.

Keep your head up Birdman, it has to get better.

ANALYST CERTIFICATION

I, Christopher R. Ellinghaus, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject companies and their securities. I further certify that no part of my compensation was, is, or will be directly, or indirectly, related to the specific recommendations or views contained in this research report.

Financial Interests: Neither I, Christopher R. Ellinghaus, nor any member of my household owns securities in any of the subject companies mentioned in this research report. Neither I, nor a member of my household is an officer, director, or advisory board member of the subject company or has another significant affiliation with the subject company. I do not know or have reason to know at the time of this publication of any other material conflict of interest.

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WILLIAMS CAPITAL EQUITY RESEARCH RATINGS KEY

BUY: In the analyst's opinion, the stock will outperform the S&P 500 on a total return basis over the next 12 months.

HOLD: In the analyst's opinion, the stock will perform in line with the S&P 500 on a total return basis over the next 12 months.

SELL: In the analyst's opinion, the stock will underperform the S&P 500 on a total return basis over the next 12 months.

DISTRIBUTION OF EQUITY RESEARCH RATINGS AS OF: JULY 28, 2017

	Buy	Hold	Sell
All Research Coverage:	52.6%	42.1%	5.3%
Universe of IBC:	100.0%	0.0%	0.0%
Utilities:	42.9%	42.9%	14.3%
Utilities—IBC:	100.0%	0.0%	0.0%

IBC (Investment Banking Clients) is defined as companies in respect of which The Williams Capital Group, L.P. (the "firm") or its affiliates have received or are entitled to receive compensation for investment banking services in connection with transactions that were publicly announced in the past 12 months.

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